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**Citation:** Lampel, J., Bhalla, A. and Jha, P. P. (2014). Does governance confer organisational resilience? Evidence from UK employee owned businesses. *European Management Journal*, 32(1), pp. 66-72. doi: 10.1016/j.emj.2013.06.009

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# **Does Governance Confer Organisational Resilience? Evidence from UK Employee Owned Businesses**

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Feb2014, Vol. 32 Issue 1, p66-72.

DOI: 10.1016/j.emj.2013.06.009.

## **ABSTRACT**

Current economic crisis has highlighted the importance of an organization's ability to withstand economic shocks. This has rekindled the interest in organization resilience on the one hand, and the relationship between alternative governance forms such as employee owned businesses (EOBs) on the other. We explore this relationship using performance data on 204 publicly traded non-employee owned businesses and 49 EOBs prior to the economic downturn (2004-2008), and during the economic downturn (2008-2009). This data is complemented with a survey of resilience related governance and organizational practices in 41 EOBs and 22 non-EOBs. Our results show that: a) employee ownership form is associated with greater stability in business performance over a business cycle; b) EOBs have longer payback horizon when compared to non-EOBs across a number of activities; c) EOBs top management seek employee input beyond operational aspects by involving them in strategic decision making; d) EOBs achieve tighter coupling between the feedback from operations and the feed forward on strategic direction. These results suggest that employee stock ownership programs alone are not sufficient to develop higher levels of organizational resilience. Managers must combine employee stock ownership with employee involvement in governance if they wish to build up resilience in advance of adverse economic conditions.

## 1. INTRODUCTION

The recent economic crisis and the prolonged economic recession that has ensued is focusing increasing attention on ‘organizational resilience’: the organization’s capacity to cope with “unanticipated dangers after they become manifest (Wildavsky, 1988: 147)”. Critics of shareholder capitalism have argued that the ownership-governance model that currently dominates many industrial and financial corporations limits organizational resilience (Davies, 2009). Past research on the relationship between ownership and governance has concentrated on financial performance, with a view to exploring which ownership-governance arrangement produces optimal allocation of resources and effective strategic decision-making (Connelly et al., 2010). Until recently, there has been little if any research on the relationship between ownership-governance arrangements and organizational resilience (Marchington and Kynighou, 2012). The failure of a wide range of firms as the crisis has taken hold suggests that resilience should be viewed as central to organizational strategy. Since the failure in many instances has also been one of governance, this in turn highlights the need to examine more closely whether ownership-governance arrangements have a substantial impact on organizational resilience.

This paper examines this issue by looking at the relative performance of two ownership-governance arrangements during the recent economic crisis. The first is the dominant textbook case of publicly traded share-holding firms in which governance is exercised through board of directors that are accountable to the external shareholders. The second ownership-governance arrangement is one where employees substantially own and control the firm. We used two sets of data to compare these two different ownership-governance arrangements. We use secondary data to analyze performance of 49 employee

owned businesses (EOBs) and 204 non-employee owned businesses (non-EOBs) in the UK from 2005-2009. This is complemented by a survey of 41 employee owned businesses and 22 non-employee owned businesses that looked at managerial practices in each type of firm. Our analysis of the performance data show that EOBs are more resilient than non-EOBs. We follow this with analysis of managerial practices that points to differences in employee voice and involvement that may account for higher resilience.

The paper is structured as follows. We begin with an overview of the concept of organizational resilience. We then examine current research on the relationship between organizational resilience and stakeholders' governance. We then turn our attention to governance in employee owned businesses, contrasting publicly traded corporations where owners are generally external to the organization, with firms where employees substantially own and exercise control over the organization.

We begin by looking at elaborating the role governance plays in ensuring long-term stability of the firm. Next, we highlight employee-ownership governance structure and why EOBs are a case for more resilient organisations. We then present our research methodology and discuss the findings of our research. Finally, we close with a discussion and implications for the managers and future research directions.

## **2 THEORETICAL BACKGROUND**

### **2.1 Crisis, Resilience, And Governance**

The literature on organizational resilience emerged from the study of organizations that experience unexpected events such as natural disasters or nuclear accidents that have major consequences in terms of damage to property and loss of lives (Bigley and Roberts, 2001). Framed in this context, resilience is defined as the ability of the organization to “bounce back

in the face of disturbance” (Comfort, Boin and Demchak, 2010). In other words, the organization should not only survive, but also retain more or less the structure and functions it had prior to the event.

Resilience is clearly a desirable property. Most managers are aware that sooner or later they will face unforeseen situations that can put their organization seriously at risk of failure. Building resilience into the organization is therefore strategically advisable, but potentially also costly. For example, firms can protect themselves against supply chain disruptions by spreading their purchasing of inputs across multiple suppliers, but this usually entails higher costs. Likewise, firms can develop a variety of stand-by teams to deal with a variety of unexpected problems such as quality failures or unusual customer requests, but this will also add to their overheads.

Building resilience into the organization therefore becomes a process of balancing costs against potential risks. In so called ‘high-reliability organizations’ where operational failure can have catastrophic consequences costs clearly take second place to achieving resilience. These organizations, as Weick and Sutcliffe (2007: 37) point out, are preoccupied with failure. Structuring operations around resilience therefore makes sense in spite of much higher costs. For business organizations that do not face the same type of risks achieving resilience for its own sake without regard to costs is clearly not a practical option. Instead, these organizations have to rely on the resilience of the structures, systems, and processes that exist already but operate primarily to meet the tasks of making products and serving customers. This resilience is ‘latent’ by contrast to ‘designed’ resilience which organizations develop specifically to address threats that can potentially damage the viability of an organizations. In effect, latent resilience is an emergent property created as a byproduct of what the organization needs to do to function normally.

Researchers have focused on a variety of organizational factors that contribute to

latent resilience. Structural flexibility is often cited as creating latent resilience (Bigley and Roberts, 2001; Lin et al., 2006). Organizations that are structurally flexible are better able to adjust when faced with unforeseen contingencies such as rapid fall in demand by reallocating resources. Another factor that improves resilience is the accumulation of slack resources. Organizations often accumulate slack resources for reasons that are not directly linked to improving resilience. Nevertheless, these slack resources can be mobilized to meet urgent needs when adverse contingencies arise unexpectedly.

Both structural flexibility and slack represent operational attributes that are macro properties that correlate positively with resilience. Researchers have also examined micro properties that contribute to organizational resilience. Marchington and Kynighou (2012) highlight the importance of high level of employee engagement that enables firms to successfully differentiate themselves from the competitors in times of crises. Gittell and Douglass (2012) have argued that “relational reserves”, the interpersonal bonds among employees are crucial for dealing with crises. Roberts, Stout, and Halpern (1994) have argued that locus of decision- making also has important implications for organizational resilience.

Organizations in which top management centralizes decision making will be less resilient than organizations in which decision-making authority is allowed to migrate downwards and outwards, closer to the actual site where decisions have to made.

Thus far the growing body of research on organizational resilience has focused primarily on exploring internal organizational factors that contribute directly to resilience. More recently, attention has turned to the relationship between resilience and external stakeholders. Specifically, researchers have begun to ask whether patterns of ownership, and hence governance, encourage the development of internal organizational factors that in turn increase resilience. A recent special issue in *Entrepreneurship Theory and Practice*

examined resilience in family firms (Chrisman, Chua, and Steier, 2011). Kachaner, Stalk, and Bloch (2012) also argue that resilience is one of the characteristics that distinguish family firms from non-family firms. Amann and Jaussaud (2012) tested this proposition by looking at the resilience of Japanese family vs. non-family family firms during the Asian crisis of 1997 using a sample of 98 firms of each type. They conclude that family firms “resist the downturn better, recover faster, and continue exhibiting higher performance and stronger financial structures over time (p. 203)”.

## **2.2 Governance And Employee-Ownership**

Studies of family firms suggests that governance creates the institutional foundations that allow for the growth of organizational factors that directly contribute to the emergence of resilience. Corporate governance is broadly defined as the mechanisms through which “firms operate when ownership is separated from management (Claessens, 2003, page 5)”. Findings that point to resilience as one of the advantages of this type of overlap, also suggest that broadening the overlap between owners and managers should likewise result in higher organizational resilience (Conelly et al., 2010). Employee owned business in which managers and salaried employees own controlling shares in the enterprise represent a case where the overlap is extensive, and at times complete.

Employee owned businesses (EOB's) form a small but significant part of the economic landscape in advanced industrial countries. It is important to distinguish EOBs from the more common case of firms where employees participate in programs such as ‘employee stock ownership’. In firms where employees are given the opportunity to buy shares, but are not allowed voice in the governance of the enterprise, their role as managers and employees does not differ substantially from any other corporation where ownership is widely dispersed, and is exercised through an elected board of directors. In EOBs, on the

other hand, employee owners exercise both direct and indirect influence. They are often in the position to oversee the firm's strategy and financial health via representatives on the board, and they are also more often empowered to exercise 'voice' when communicating views and information upwards.

Research on employee owned business focuses on two models of the relationship between the employees and their organization (Wagner, Parker, and Christiansen, 2003). The first model argues that employee behaviour is affected by the extrinsic rewards that flow from owning shares. In other words, employees are more likely to take actions, and be receptive to actions, that will increase the wealth of the firm. The other model looks at the motivations and actions of employees in employee owned firms from a different perspective. This model argues that employees in employee owned firms develop a wider sense of ownership that has strong psychological ramifications (Pierce, Rubenfeld and Morgan, 1991). Their relationship to the organization is not confined to calculation of what will increase returns on their shares, but extends beyond to an ownership mindset that is essentially non-calculative. Thus they are more likely to share information, back decisions that may be costly in the short-run, and exercise initiative without the prospect of immediate rewards. More generally, employee ownership mindset is widely believed to promote cooperation, foster shared interests, and reinforce norms.

Although these outcomes of employee ownership are positive – indeed they conform to what researchers generally see as best organizational practices – this still leaves the question of whether they translate to higher resilience. Resilience, as we noted earlier, is the ability to 'bounce back' after dealing with unanticipated events with adverse effects on the organization. Employee attitudes and behaviour in employee owned firms contributes to researchers' prediction of organizational properties that correlate with resilience: flexibility, open communication, quick resource mobilization, and decisions migrating to persons best



qualified to handle crisis. Research on resilience, however, does not confine these properties to employee owned businesses - or for that matter to any other type of firm defined by ownership structure. The question that inevitably emerges is whether organizational properties that are the product of ownership relationship to the firm impact resilience. We examine this question by looking specifically at the performance of employee owned versus non-employee owned during the economic crisis of 2008-2009.

### **3. RESEARCH SETTING, DATA AND METHODS**

The employee-owned sector is estimated to have a value of £30 billion, accounting for 2% of UK GDP. (Employee Ownership Association, 2012). Our study set out to broadly examine the relationship between features of employee-ownership model- such as inclusive decision-making in areas such as product design to introducing flexible work practices, with business performance. As we began to design our study in the autumn of 2008 the emerging economic crisis gave us a unique opportunity to compare the performance of EOBs and non-EOBs under adverse circumstances. We therefore added the following questions to our study:

- How well do EOBs perform during an economic downturn relative to their performance during a period of economic growth?
- How well do EOBs perform during an economic downturn relative to non-EOBs?

To answer these questions we not only collected company financial and commercial data, but also designed a questionnaire that probed attitudes on key issues that are of relevance to EOBs in general, and of particular salience when the employee-ownership model is being tested by difficult economic circumstances. Our findings assess the strength of employee ownership as a governance model that is not only fairer but also more resilient.

We began by constructing a sample of employee owned businesses. Our sample draws

on Employee Ownership Association list of member companies that explicitly identify themselves as ‘employee owned’. We use the Employee Ownership Association (EOA) definition for EOBs as businesses that “are substantially or wholly owned by the people who work for them”. Although the EOBs that were in our sample had employee ownership ranging from 32% to 100%, the crucial demarcation for us was membership in the EOA and clear identification their communications that these firms regarded themselves as employee owned.

We were able to obtain detailed financial data on 49 self-identified EOBs that were members of EOA. This sample was matched with 204 non-EOBs. Firms in the sample vary in size from seven employees to 69,000 employees with sales turnover ranging from £20,000 to nearly £7 billion. The sample firms include a broad spectrum of businesses. Our data for the EOB and non-EOB firms includes companies operating in a wide range of sectors including consultancy, software development, retail, manufacturing, energy, health care and financial services. We control for the industry effect in the sample by accounting for any influence on results due to concentration from certain sectors.

The analysis of secondary financial data was complemented by a survey of managerial practices in EOBs and non-EOBs. We reached out to all the 67 EOBs from EOA member directory and received 41 responses (response rate of 61%). We also reached out to the matched list of 204 publicly traded non-EOBs and received responses from 22 non-EOBs (response rate of 10.7%). All the respondents were senior personnel at the surveyed firms; most were either chief executive officers or held directorial positions at their respective organizations.

## 4. FINDINGS

### 4.1 Governance and Long-term Performance: EOBs vs. Non-EOBs

Our findings examine a time horizon running across business cycles. This comprises a time period prior to the downturn (2004-2008), and then the period that saw the downturn beginning to have an impact on business performance and strategies (2008-2009). Our findings suggest that employee ownership form is associated with greater stability in business performance. We use two indicators of performance: sales turnover (table 1) and; profitability (table 2). In both instances, the downward shift in turnover and profitability is much sharper for non-EOBs than for EOBs. This suggests that non-EOBs have been impacted more severely by the downturn, and by extension, EOBs come through as more resilient businesses.

*Table 1: Increase in sales turnover*

Increase over the period.....	2005-2008		2008-2009	
	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in sales turnover (mean)	10.04% <sup>b,c</sup>	12.10%	11.08%	0.61%
Average per annum increases reported for 2005-2008. <sup>b</sup> t-test for the difference of means; <i>statistically significant difference between EOBs and non-EOBs over both time periods</i> (p<0.05). <sup>c</sup> Raw scores reported, scaled normalised scores were used for analysis				

*Table 2: Increase in Profits before Interest and Taxes (PBIT)*

Increase over the period.....	2005-2008		2008-2009	
	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in PBIT (mean)	10.91% <sup>b,c</sup>	14.88%	3.21%	2.08%
Average per annum increases reported for 2005-2008. <sup>b</sup> t-test for the difference of means; <i>no</i>				

statistically significant difference between EOBs and non-EOBs. <sup>c</sup>Raw scores reported, scaled normalised scores were used for analysis

Another important indicator of long-term performance is investments firm make in the form of adding new employees. Firms are known to shed employees in tough times and add in good times. The data also suggest that EOBs are significantly stronger in terms of generating new employment both during boom and during recessionary times (table 3).

*Table 3: Increase in number of employees*

Increase over the period.....	2005-2008		2008-2009	
	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in employee numbers	7.46% <sup>b,c</sup>	3.87%	12.91%	2.70%
Average per annum increases reported for 2005-2008. <sup>b</sup> t-test for the difference of means; <i>statistically significant differences between EOBs and non-EOBs for both time periods</i> (p<0.01). <sup>c</sup> Raw scores reported, scaled normalised scores were used for analysis				

This characteristic, couples strongly with evidence that shows that EOBs perform much better than non-EOBs in terms of employee contribution to performance (profitability per employee and turnover per employee) during recessionary times (table 4 and table 5).

*Table 4: Increase in Sales turnover per employee*

Increase over the period.....	2005-2008		2008-2009	
	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in sales turnover / employee	1.33 <sup>b,c</sup>	2.94%	0.97%	0.22%
Average per annum increases reported for 2005-2008. <sup>b</sup> t-test for the difference of means; <i>statistically significant difference between EOBs and non-EOBs for the time period 2008-2009</i> (p<0.05). <sup>c</sup> Raw scores reported, scaled normalised scores were used for analysis				

*Table 5: Increase in PBIT per employee*

Increase over the period.....	2005-2008		2008-2009	
	EOBs	Non-EOBs	EOBs	Non-EOBs
Increase in PBIT/ employee	1.51% <sup>b,c</sup>	3.78%	0.25%	0.68%
Average per annum increases reported for 2005-2008. <sup>b</sup> t-test for the difference of means; <i>statistically significant differences</i> between EOBs and non-EOBs for the time period 2005-2008( $p < 0.05$ ). <sup>c</sup> Raw scores reported, scaled normalised scores were used for analysis				

EOBs hire more and also show superior productivity and profitability per employee across business cycles while non-EOBs show a sharp decline in both. This indicates that EOBs are not only more resilient but also impart more stability to the economy on the fronts of employment and employee productivity. Stronger employee contribution thus seems to be a pivotal factor that makes the EOBs more resilient in terms of being less susceptible to turbulence over business cycles.

#### **4.2 What does it take to be Resilient: Features of Governance Practice that lead to Resilience**

##### ***Employee Involvement in Decision-making***

As we discussed above one of the key organizational features that may lead to EOB resilience is employee involvement in decision-making. In the survey we asked respondents to indicate the extent to which employees were involved in different decision making roles. We elicited responses on roles to do with business area/department level operational decisions, new product decisions, board level decisions, and the say employees had in setting the overall strategy and direction of the business.

Our results show a statistically significant difference ( $p < 0.05$ ) between EOBs and non-EOBs for all of these roles, with EOBs showing higher employee involvement in decision making by employees across all levels. We found the difference to be strongest for employee role in board level decisions followed by employees' having an important say in business area level decisions and then employee role in setting overall strategy and direction of the business.

We infer that employees in EOBs are not only more involved in operational aspects of the business but also in setting long-term organizational goals and direction of the business. Employee involvement in non-EOBs is oriented towards seeking their input at early stages of product lifecycle. This is considered vital for generating feedback about aspects such as what product attributes are likely to work in the market, and to some extent, about nature of capabilities that are required to deliver new product configurations. This contrast shows that EOB governance facilitates employee input beyond operational aspects by involving them in strategic decision making more explicitly. This in turn delivers a tighter coupling between the feedback from operations and the feed forward on strategic direction – argued as fundamental to stability in long term performance.

### ***Short vs. Long-term focus in the business***

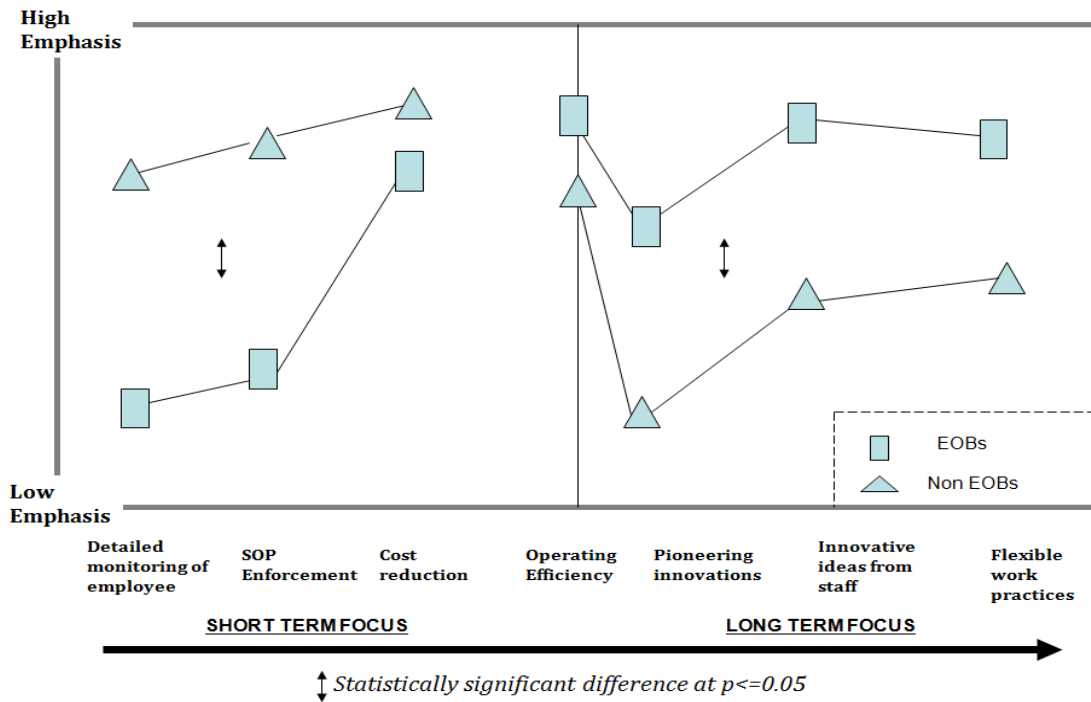
In the survey we asked respondents to rate the importance their organizations attached to activities that have shorter vs. longer payback horizon. We took this as a proxy for the strategic direction that is set at board level and translated this into importance that is attached to different activities in a business. The items we listed for short payback horizon were activities that promoted cost reduction, involved detailed monitoring of employees, and increased enforcement of standard operating procedures. The items that stood for long payback horizon were willingness to pioneer innovations, introducing flexible work practices,

and actively seeking innovative ideas from employees. We also asked respondents to rate emphasis on operational efficiency which we see as a mid way mark between the two orientations.

Our results show that EOBs have longer payback horizon when compared to non-EOBs across a number of activities (see figure 1). Specifically, our data shows that EOBs are more likely to support pioneering of innovations than non-EOBs. By contrast, non-EOBs are more preoccupied with efficiency and costs than EOBs who put greater emphasis on forward growth planning. EOBs encourage first-line and middle management to take initiative, and are less preoccupied with maintaining standard operating procedures.

Using unpaired t-tests we find statistical significance differences that indicate a very insightful pattern (see figure 1). This pattern clearly indicates that the employee based governance mechanism at EOBs orients activities towards a longer payback horizon creating a stable performance pattern over time. Non-EOBs in contrast seem to be led by shorter payback horizon being prone to responding through radical and short term manoeuvres when faced uncertainty and turbulence as during these recessionary times. Contrasting the evidence on strategic orientation for EOBs with non-EOBs thus provides a validation for the argument that employee based governance is an important aspect of EOBs being more resilient.

**FIGURE 1**



## 5. DISCUSSION

The findings in this paper have relevance to two distinct conversations. First, our findings show that during the recent economic crisis EOBs performed better than non-EOBs. This has implications not only to resilience in terms of survivability, but also to resilience in terms of EOBs being able to maintain their operations and hold on to social and intellectual capital during severe economic downturns. Second our findings are also relevant to the wider conversation about organizational resilience more generally. Once we acknowledge that resilience can be an important strategic capability, it becomes important to examine organizational practices that enhance this capability.

Looking at the comparative analysis of EOBs and non-EOBs we see that ownership-governance arrangements have clear performance implications. The survey results highlight



the reasons for EOB resilience in the face of adverse economic conditions. Employee commitment and flexibility during economically difficult conditions are one explanation that is often cited by students and observers of EOBs. Our data supports this view, but also suggests another factor that is more strategic in character: EOBs see business risk differently from non-EOBs who are often more driven by shareholder value. In addition, EOBs are more conscious on of the need to balance human capital availability against business opportunity. Employee recruitment process in EOBs therefore tends to constrain short-term risk taking. EOBs look at new business opportunities from the perspective of building sustainable business units.

## **6. IMPLICATIONS AND CONCLUSIONS**

Turning our attention to the wider conversation about organizational resilience, what implications can be drawn from our study that are relevant to businesses that are not employee owned? To begin with, our results suggest that reliance on employee stock ownership alone in motivating employees cannot account for the difference in performance between EOBs and non-EOBs. The increasing use of employee stock ownership program is often based on an ‘agency’ perspective of the relationship between employees and their firms (Royer et al., 2008). Such an approach argues that stock ownership will align the interests of employees with shareholders. Our study suggests ownership must be combined with employee involvement for this type of programs to be effective. From a resilience perspective, employee involvement in governance becomes crucial when organizations face adverse economic conditions.

The advantages of resilience are clear when organizations face crisis. But building resilience is not easy. Research on strategic turnaround often emphasizes the shedding or resources and cost cutting as essential to survival. But survival should not be equated to

resilience. Resilience is the ability of organizations to maintain not only operational integrity, but also preservation of social and intellectual capital that is crucial to the long-run success of organizations. Building resilience therefore entails adaptive processes that promote competence upgrading and simultaneously restore efficiency. These processes are embedded in organization structures and practices that deepen coordination and boost the ability to quickly process feedback and flexibly rearrange or transfer knowledge to deal with situations as they arise (Sutcliffe and Vogus, 2003).

Based on the findings in these paper we would argue that these adaptive processes are more likely to take root in organizations where employees have substantial ownership stake linked to the ability to exercise voice. In the current debate over the foundations of corporate capitalism this point has particular salience precisely because prior to the crisis there were many who argued that ownership is the strongest tool for ensuring that employee motivation points in the right direction. The crisis that first emerged in the financial industries, a sector where employee ownership was widely used, suggests that ownership alone is not only far from sufficient, but may have perverse consequences that can threaten the viability of the firm. In this respect, our study should renew attention to the way that ownership is exercised both by employees that own shares, and by external investors who have a stake in the performance of the firm.

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